

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 97-0566

Adjusted Gross Income Tax

Fiscal Years Ending 11/30/91, 11/30/92, 11/30/93, 11/30/94, and 11/30/95

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ISSUE(S)

I. Adjusted Gross Income Tax – Michigan Single Business Tax

Authority: I.C.6-3-1-3.5 (b); 45 IAC 3.1-1-8 (3)(a); *Miles v. Dept. of Treasury*, 209 Ind. 172 (1935); I.R.C. Section 61 (a); *Eisner v. Macomber*, 252 U.S. 189 (1920); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); I.R.C. Section 62

Taxpayer protests the add back of the Michigan Single Business Tax.

II. Tax Administration – Penalty

Authority: IC 6-8.1-10.1; 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer, in a letter dated September 29, 1998 protested the add back of the Michigan Single Business Tax in an audit completed on July 11, 1997. Taxpayer is an Ohio corporation qualified to do business in Indiana on October 26, 1942.

I. Adjusted Gross Income Tax – Michigan Single Business Tax

DISCUSSION

At issue is whether the taxpayer is subject to the add back of the Michigan Single Business Tax.

In calculating Indiana adjusted gross income, state taxes based on or measured by income must be added back to federal "taxable income". IC 6-3-1-3.5(b)(3). Taxpayer argues that the Michigan

Single Business Tax (MSBT) is not a tax based on or measured by income, therefore, should not be added back to federal taxable income.

The MSBT uses federal taxable income as a starting point and then makes several adjustments to arrive at what is essentially a gross income figure. An analogy can be drawn between MSBT and the Indiana gross income tax, the latter of which must be added back in computing Indiana adjusted gross income for corporations, which pay gross income tax. See Rule 45 IAC 3.1-1-8 and *Miles v. Department of Treasury*, 209 Ind. 172 (1935). While these two taxes are computed differently, they are similar in that both include more than just a net income tax component.

The critical element in determining whether the MSBT is based on or measured by income is to compare the Internal Revenue Code's definition of gross income with the MSBT calculations. Gross income includes "all income from whatever source derived," except as specifically excluded by provisions of the Code or other federal law (I.R.C. Section 61 (a)). The Supreme Court first defined income in *Eisner v. Macomber*, 252 U.S. 189 (1920) as "the gain derived from capital, from labor, or from both combined, including profit from the sale or conversion of capital assets." The Supreme Court has repeatedly held that in defining "gross income" as broadly as it did, Congress intended to tax all gains except those specifically exempted. See *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955). Internal Revenue Code, Section 62 lists specific types of income, which are included in gross income. If this code section is compared to the MSBT calculations, it is apparent that the MSBT is based on or measured by income. All of the components used in calculating MSBT are likewise components of gross income. In support of this comparison, the Michigan Tax Base is attributable to the operation of the particular taxpayer's business. The MSBT add backs were, as a whole, originally deducted from federal gross income. Consequently, MSBT is based on or measured by income and is a required add back in arriving at Indiana Adjusted Gross Income.

FINDINGS

Taxpayer's protest is respectfully denied. Indiana Code Section 6-3-1-3.5(b)(3) requires the add back of taxes based on or measured by income and levied at the state level. MSBT is levied at the state level and is measured by income; therefore MSBT is a required add back.

II. Tax Administration - Penalty

DISCUSSION

Taxpayer protests the imposition of the ten percent (10%) negligence penalty. The negligence penalty imposed under IC 6-8.1-10-2.1 may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and

prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(c).

The primary issue in the audit is the Michigan Single Business Tax as an add back for Indiana Adjusted Gross Income tax purposes. The taxpayer added back the Michigan Single Business Tax for adjusted gross income tax purposes in the prior audit and past years including the periods ending 11/30/91, 11/30/92, and 11/30/93 but failed to add back in 1994 and 1995. Based on this information and 45 IAC 15-11-2, the negligence penalty will not be waived.

CONCLUSION

The taxpayer's protest is denied with respect to Issues I and II.